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ABSTRACT

This instructor guide for a unit on legal issues in the PACE (Program for Acquiring Competence in Entrepreneurship) curriculum includes the full text of the student module and lesson plans, instructional suggestions, and other teacher resources. The competencies that are incorporated into this module are at Level 3 of learning--starting and managing one's own business. Included in the instructor's guide are the following: unit objectives, guidelines for using PACE, lists of teaching suggestions for each unit objective/subobjective, model assessment responses, and overview of the three levels of the PACE program. The following materials are contained in the student's guide: activities to be completed in preparation for the unit, unit objectives, student reading materials, individual and group learning activities, case study, discussion questions, assessment questions, and references. Among the topics discussed in the unit are the following: complying with rules and regulations affecting business, developing policies for compliance with government regulations, identifying business contracts, selecting business contracts, and determining the use of legal assistance. (KC)

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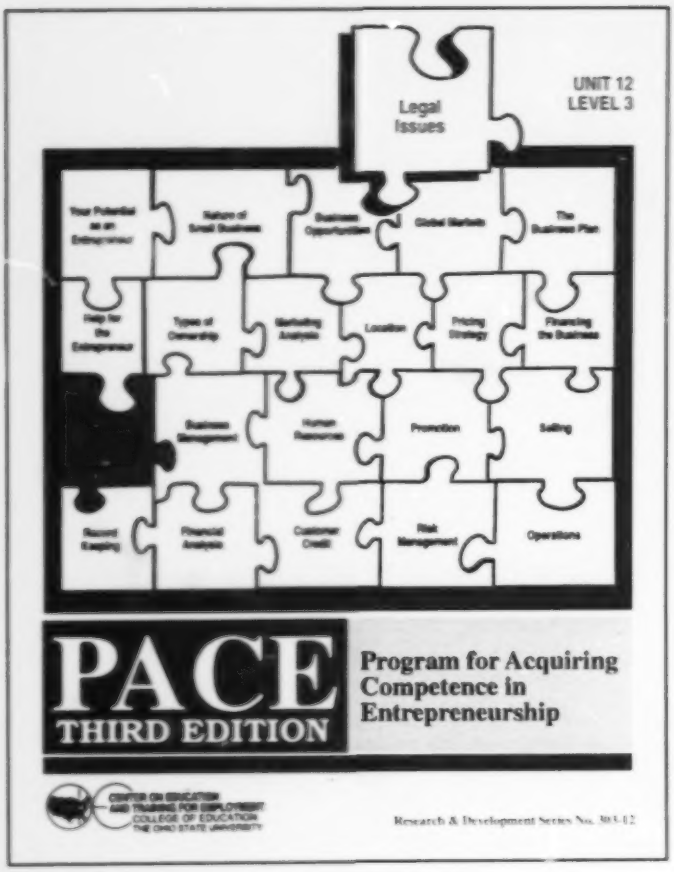

INSTRUCTOR GUIDE

Unit 12

Legal Issues

Level 3

Objectives:

- Acquire the information necessary to comply with the various rules and regulations affecting your business.
- Develop policies for your business to comply with government regulations.
- Identify contracts used in business.
- Select the contracts used in business.
- Determine the use of legal assistance for your business.

HOW TO USE PACE

- Use the objectives as a pretest. If a student is able to meet the objectives, ask him or her to read and respond to the assessment questions in the back of the module.
- Duplicate the glossary from the *Resource Guide* to use as a handout.
- Use the teaching outlines provided in the *Instructor Guide* for assistance in focusing your teaching delivery. The left side of each outline page lists objectives with the corresponding headings (margin questions) from the unit. Space is provided for you to add your own suggestions. Try to increase student involvement in as many ways as possible to foster an interactive learning process.
- When your students are ready to do the *Activities*, assist them in selecting those that you feel would be the most beneficial to their growth in entrepreneurship.
- Assess your students on the unit content when they indicate they are ready. You may choose written or verbal assessments according to the situation. Model responses are provided for each module of each unit. While these are suggested responses, others may be equally valid.

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Objectives	Teaching Suggestions
1. ACQUIRE THE INFORMATION NECESSARY TO COMPLY WITH THE VARIOUS RULES AND REGULATIONS FOR AFFECTING YOUR BUSINESS	
Who can assist the small business owner with legal problems?	As an out-of-class assignment have the class peruse local business directories and compile list of people or companies that can assist the small business owner with legal requirements and/or problems.
Does the small business owner need an attorney?	Discuss the importance of seeking qualified technical assistance when dealing with issues of the law.
2. DEVELOP POLICIES FOR YOUR BUSINESS TO COMPLY WITH GOVERNMENT REGULATIONS	
Why are government rules and regulations important?	Divide the class into two groups; after allowing the groups time to prepare have them debate the ethical issue of government intervention concerning matters of small business. Play the "devil's advocate" by designing probing, specific questions/issues to be debated. Example: If this is supposed to be a free country, why does the government tell business how to operate?
What are sources of regulations?	Explain that the sources of small business regulations vary from local, to state, to federal entities.
How can federal regulations be classified?	Review the importance of maintaining the conditions necessary for fair competition to take place. Discuss each of the principal antitrust laws and their intended purposes.
What steps can be taken to comply with the laws protecting competition?	As an outside assignment task the class with doing research on famous antitrust cases throughout our history (e.g., the United States Football League (USFL) vs. the National Football League (NFL), the breakup of the Bell Telephone System etc.
What steps can be taken to comply with laws protecting employees?	Gather as many of the pamphlets regarding the rights of employees and share them with the class (see the PACE Resource Guide for sources).
How does the law protect consumers?	Introduce the concept consumer advocacy or "watchdog" groups and individuals (e.g., Consumer Report, Ralph Nader).
What steps can be taken to comply with laws protecting consumers?	Highlight the fact that both the small business *and* the consumer benefit from compliance with consumer rights laws.

Objectives	Teaching Suggestions
What steps can be taken to comply with laws protecting the environment?	Procure a video from the local library or environmental group that focuses on the issues facing our environment. Heightening the awareness of your students regarding these issues will help reinforce the rationale for the environmental protection laws discussed in the text.
3. IDENTIFY CONTRACTS USED IN SMALL BUSINESS	
What licenses and permits are needed?	Your local SBA office will gladly supply you with compliance-related literature to share with the class.
What is a contract?	On the chalkboard or overhead write define a *contract.*
What are the major elements of a contract?	Using the chalkboard or overhead list and discuss each of the major elements of a contract.
What are the most common types of contracts?	Try to procure samples of common contracts (a guest speaker may be able to provide these ahead of time). Photocopy these samples for use by the class and outline the major elements that are included in each.
What is a lease?	Refer to above suggestion.
What types of leases are available?	Review the types of leases listed in the text.
Why lease equipment?	Using the chalkboard or overhead highlight the advantages of leasing equipment. Then contrast these advantages to lease with suggestions from the class about some possible disadvantages.
What are sales contracts?	Describe the ultimate importance of a quality sales contract to anyone who is considering the purchase of an existing business.
4. DESCRIBE THE APPROPRIATE PROCESS TO PROTECT INTELLECTUAL PROPERTY FOR YOUR BUSINESS IDEA	
How can business ideas be protected?	Review the concepts of patents, trademarks, service marks, and copyrights. Present examples when possible.
5. DETERMINE HOW THE SMALL BUSINESS OWNER CAN REDUCE LEGAL PROBLEMS	
How can the small business owner reduce legal problems?	Drawing on all of the data in this unit have the students suggest several ways to reduce legal problems.

MODEL ASSESSMENT RESPONSES

1. Federal, state, and local governments are the source of rules and regulations that govern small business. As the world of small business grows the laws and regulations are continuously revised in order to stay current. The main purpose of these laws and regulations is to ensure a healthy business environment.

2. The Clayton, Robinson-Patman, and the Sherman Acts are all *anti-trust laws* designed to protect *competition*, the cornerstone of the free enterprise system.

3. OSHA is an acronym for the Occupational Safety and Health Act. Its purpose is to enact legislation to protect the health and safety of workers while on the job.

4. All parties entering into a contract must have the intellectual *ability* to make legally binding agreements.

5. The first step a business should take to ensure compliance with laws protecting the environment is to contact the local office of the Environmental Protection Agency (EPA) to find out the responsibilities of your particular type of business.

6. Explain the purpose and use of a *patent*.

PACE THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

Incorporates the needed competencies for creating and operating a small business at three levels of learning, with experiences and outcomes becoming progressively more advanced.

Level 1 — Understanding the creation and operation of a business.
Level 2 — Planning for a business in your future.
Level 3 — Starting and managing your own business.

Self-contained **Student Modules** include: specific objectives, questions supporting the objectives, complete content in form of answers to the questions, case studies, individual activities, group activities, module assessment references. **Instructor Guides** include the full text of each student module and lesson plans, instructional suggestions, and other resources. **PACE, Third Edition, Resource Guide** includes teaching strategies, references, glossary of terms, and a directory of entrepreneurship assistance organizations.

For information on PACE or to order, contact the Publications Department at the
Center on Education and Training for Employment, 1900 Kenny Road, Columbus, Ohio 43210-1090
(614) 292-4353, (800) 848-4815.

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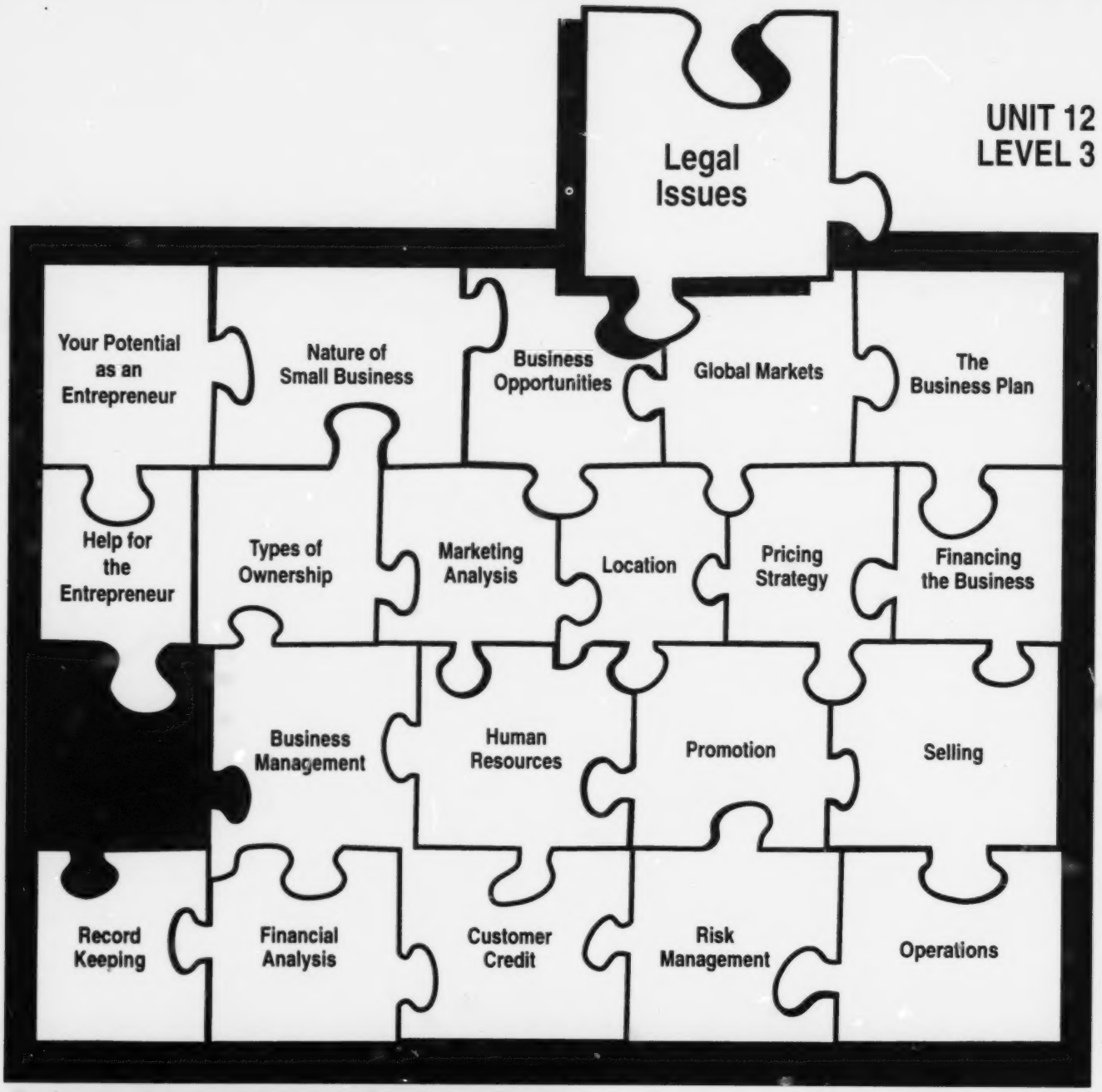

UNIT 12
LEVEL 3

PACE
THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

CENTER ON EDUCATION AND TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
THE OHIO STATE UNIVERSITY

Research & Development Series No. 303-12

LEGAL ISSUES

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read What are the Objectives for this Unit on the following page. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met at Level 1 and Level 2:

   Level 1

   - Discuss how laws affect the small business operation.
   - Discuss the importance of government rules and regulations.
   - Define the term "contract" and discuss its importance.
   - Identify the components of a contract.
   - Define patents, copyrights, and trademarks.

   Level 2

   - Classify government regulations according to whom they are designed to protect.
   - Identify the regulations that affect your business idea.
   - Explain the five essential components of a contract.
   - Identify the major types of contracts used by entrepreneurs.
   - Explain the methods of protecting your business idea.

4. Look for these business terms as you read this unit. If you need help with the meanings, ask your instructor for a copy of the PACE Glossary contained in the *Resource Guide*.

   Affirmative action
   Antitrust
   Antitrust compliance program
   Federal Reserve System
   Food and Drug Administration
   Improper labeling
   Internal Revenue Service
   Monopoly
   Office of the Federal Register
   Stipulation
   Worker's compensation coverage

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LEGAL ISSUES

WHAT ARE THE OBJECTIVES FOR THIS UNIT

Upon completion of this unit you will be able to--

- acquire the information necessary to comply with the various rules and regulations affecting your business,
- develop policies for your business to comply with government regulations,
- identify contracts specific contracts used in small business,
- describe the appropriate process to protect intellectual property for your business idea, and
- determine how the small business owners can reduce legal problems.

WHAT IS THIS UNIT ABOUT?

Daily involvement in sales, operations, finances, and overall management leaves the small business owner with little time to assume new responsibilities. However, the importance of the legal aspects of business should not be neglected. The various legal points involved in day-to-day and long-term decisions related to the business must be understood. The small business owner will need to decide whether to improve his or her personal understanding of law or whether to delegate some of the responsibility to an attorney or other nonlegal adviser.

The small business owner, the key employees, or the firm's attorney will need to be able to cope with legal questions as they develop. Someone must decide whether a particular situation involves major or minor legal matters. Someone must be able to determine the degree of risk the firm faces when legal problems arise. If this skill is lacking in the business's management, serious consequences could develop later.

This unit is designed to provide the small business owner with information about what can be done to recognize legal issues and develop strategies to deal with them. This information should help the entrepreneur deal with legal problems effectively. Some

of the questions dealt with in this unit are as follows:

- How can the small business owner recognize potential sources of legal problems?
- How can the owner reduce legal problems?
- What are some legal issues entrepreneurs face?
- Who can assist the small business owner with legal problems?

You will learn to analyze and evaluate your business operations for the purpose of planning strategies and policies to comply with government regulations. Throughout the unit a number of step-by-step procedures for complying with certain regulations will be presented for your examination.

Topics discussed in this unit include the importance of government regulations and the classification of regulations. Contracts will also be discussed. Special emphasis will be placed on leases and sales contracts. You will learn what stipulations you may want in a sales contract to purchase an existing small business. Finally, the protection of ideas and concepts through patents, trademarks, service marks, or copyrights will be discussed.

WHO CAN ASSIST THE SMALL BUSINESS OWNER WITH LEGAL PROBLEMS?

Several individuals can assist the small business owner with legal problems. An attorney may be one of your best resources in dealing with legal issues. However, attorneys are expensive to use and not the only resource available.

In many legal problems, the service of nonlegal advisors may be helpful. These outside advisers may include accountants, bankers, insurance advisers, advertising or trade association staff members, real estate agents, management consultants, and business friends. Whether legal or nonlegal advisers are used, the small business owner should take advantage of the many resources of specialized skills that exist in the community. Although it may take time to establish an effective advisory group, the rewards are many and immeasurable.

DOES THE SMALL BUSINESS OWNER NEED AN ATTORNEY?

The entrepreneur's need for legal assistance will depend upon the nature of the small business. Highly regulated industries and business that use a number of contracts may need legal assistance on a daily basis. Other business firms may only need assistance occasionally. Some people recommend that legal advice be used before any business agreement is made. You, as an entrepreneur, must determine when you need an attorney.

Your decision will be based on your individual business and its particular needs.

There is one very important reason for selecting a competent attorney. An attorney can help you avoid personal and professional litigation. This can be a strong asset for you and for your business. Another reason for selecting a competent attorney is that he or she can help you with a number of governmental regulations. Often a knowledgeable business attorney can give you more information in 1 hour than you could get by yourself in 10 hours of reading a book on the law. In addition, an attorney's interpretation of various statutes can help the owner put money into business profits instead of lawsuits or fines.

Established businesses may require a wide variety of legal services. However, the person who is thinking of starting a new enterprise may need an attorney right away. As you learned in PACE Unit 7, *Types of Ownership*, several questions arise with a new enterprise. Should it be a sole proprietorship, a partnership, or a corporation? An attorney can provide information that will help you be more aware of the effect of this decision on the day-to-day business operations.

Another critical time for a business person is when a decision needs to be made to buy or rent a site for the business. If a lease is involved this must also be examined carefully. Too often, a standard lease is signed. Afterward, the entrepreneur learns that the standard lease did not fit the firm's particular needs. An attorney can be helpful when signing a lease.

After a business has been launched, changes in marketing techniques or in technological advances may create new demands on the business. There may be a need to establish branches or divisions. Franchise arrangements might have to be worked out. An attorney can be helpful here too.

Most small businesses need money in order to operate successfully. Some firms find that they need extra working capital in order to operate. An attorney can advise when it is better for the company to "go public" or to seek conventional loans.

As you work through this unit you will learn about many legal issues that affect business owners. You may later take a business law course to increase your knowledge about the legal system. The more you know about the law, the better equipped you will be to make decisions involving legal issues. However, you will not be a legal expert. When you are dealing with a legal issue that involves large amounts of money or complex issues, it is wise to seek the advice of an attorney. Often an ounce of preventative legal advice is cheap compared with the pound of cure it takes to get out of trouble.

WHY ARE GOVERNMENT RULES AND REGULATIONS IMPORTANT?

Most business controls are designed to protect our economic system and the people who use it. As the business world grows so do the laws that govern it. In our society today, rules and regulations are undergoing continuous revision. Economic growth and complexity have encouraged the establishment of new laws. These laws function to ensure a healthy business environment.

Oftentimes, entrepreneurs feel overwhelmed by these protective laws. However, some basic understanding of their purposes is important. Your enterprise will be in a much better position to follow appropriate laws if you plan to learn about the rules, regulations, and taxes. Awareness of the regulations you must follow will help you to establish better ways to meet your individual responsibility as an entrepreneur. It will be your responsibility to be sure your firm complies with the appropriate federal, state, and local regulations.

Regardless of the type of business you own, your business must conform to laws and regulations. It is important to remember that these rules and regulations were created for a variety of reasons, including the following:

- To protect citizens from business practices believed to be harmful
- To protect employees' interests
- To protect general public health and safety
- To protect the right to organize
- To protect business against competitors who use unfair prices and practices
- To protect consumers from the sale of harmful goods, from false advertising and selling, and from businesses that work together to keep prices high
- To protect the environment

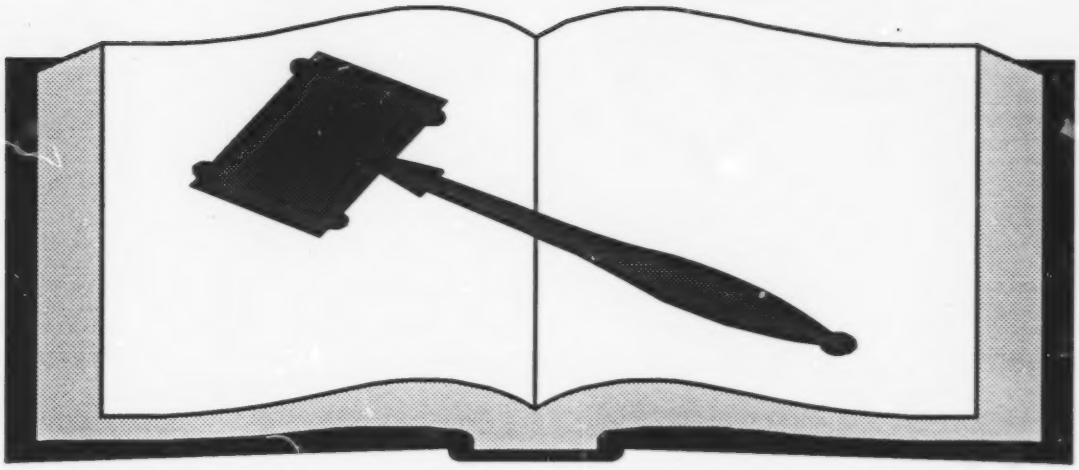
WHAT ARE SOURCES OF REGULATIONS?

Government regulations have been established for the protection of (1) competition, (2) employees, (3) consumers, and (4) the environment. The federal government regulates commerce among states. State government regulates commerce within a state's boundaries. Local governments are concerned with business operations within county or municipal boundaries.

Federal legislation is passed by the U.S. Congress. Agencies are established to enforce the regulations. Approximately 90 federal regulatory agencies exist. Some of the more important agencies are—

- the Federal Trade Commission,
- the Equal Employment Opportunity Commission,
- the Occupational Safety and Health Administration, and
- the Environmental Protection Agency.

States pass laws that govern businesses within their borders. Cities and counties also pass laws that affect how business is done. These laws often deal with licenses, land use, and building codes.



HOW CAN FEDERAL REGULATIONS BE CLASSIFIED?

Protection of Competition. In the American business system, competition is the cornerstone of our free enterprise economy. The purpose of *antitrust* laws is to preserve the conditions necessary for competition and thus to protect our economic system.

U.S. businesses are under the protection of and subject to the restraints of the federal antitrust laws. Passed under the "interstate commerce" power of the Congress, these laws affect almost every business. Hardly any retail, service, or manufacturing business is so small or local that federal antitrust laws do not apply. For example, antitrust laws have been applied against motion picture exhibitors, bowling alley proprietors, and garbage collectors. These laws are particularly important to owners of small businesses, who are often protected by antitrust legislation. It is in the self-interest of any business person to be familiar with and follow antitrust laws.

There are four principal antitrust laws in addition to a number of related federal statutes. The interpretation of these laws has been clarified by many court decisions over the years. The four main antitrust laws are as follows:

- **The Sherman Act** of 1890 prohibits the unreasonable restrain trade.

- **The Clayton Act** was designed to strengthen the Sherman Act. It specifically prohibits business acts that lessen competition or create a *monopoly*. Firstly, *price discrimination*—charging different prices to different buyers—is illegal unless the different prices are made to meet competition. Secondly, *exclusive* and *tying contracts* are illegal. Exclusive contracts require a customer to agree not to sell products of the suppliers competitors. Tying contracts occur when a customer signs two contracts for two

different products to obtain one of the products. A third illegal practice is *intercorporate stockholding*. A corporation cannot own the stock of another corporation if it results in reduced competition. The fourth practice prohibited by the Clayton Act is *interlocking directorates*. A person cannot serve on the board of directors of two or more competing companies if this would reduce competition.

- **The Robinson-Patman Act** was passed to strengthen the Clayton Act regarding price discrimination. The aim of the Robinson-Patman Act is to equalize prices to all customers if the costs of providing the goods are similar. It prohibits (1) price discounts unless there are differences in costs, (2) selling private and regular brands of an identical product at different prices, and (3) giving unequal advertising or sales promotion allowances to different buyers.

- **The Federal Trade Commission Act** of 1914 created the Federal Trade Commission (FTC). The FTC is an administrative body of experts delegated to determine and prohibit "unfair methods of competition." The Commission is empowered to deem as unfair anything that violates the spirit, not just the letter, of the federal antitrust laws. The Commission's duties also include prohibiting false or misleading material in advertising, warranties, and promotional activities. In short, the Commission's responsibilities include attacking most types of unethical business conduct. Under the FTC Act, the Commission's enforcement is limited to cease and desist order.

WHAT STEPS CAN BE TAKEN TO COMPLY WITH LAWS PROTECTING COMPETITION?

As the owner of a small business, you should consider developing an *antitrust compliance program*. If you decide to do so, you should probably enlist the help of a lawyer. Legal counsel must be well briefed concerning this particular part of the company's business. An antitrust compliance program should include the following component:

- A company policy concerning antitrust practices should give the reasons for complying with antitrust laws and the obvious types of violations of antitrust to be avoided. The policy statement should receive wide circulation within the company.

- The establishment of a training program for company personnel. Employees can only be expected to follow policies they understand.

- The establishment of internal company procedures to implement company antitrust policy. Company procedures concerning pricing, termination of dealers, marketing of new products, trade association activities, or refusals to deal should all be considered when developing the policies.

- The use of a documentation system. Documents should supply information showing that antitrust was considered in

forming policies and in decision-making procedures of the company. For example, as the company develops its new pricing policies, documents indicating that the rules of antitrust were considered in the forming of the pricing policy should be noted. The documents should be kept for possible future defense against charges of antitrust violations and could supply valuable evidence to convince a jury or court of the company's desire to comply with antitrust laws. Such evidence is important in establishing that no unethical intent existed in the minds of company officials.

- Existing company antitrust policies, educational programs, decision-making procedures, and documentation systems should be reviewed at least yearly. The changing aspects of the law and of the company operations make these audits necessary. The annual audit should determine whether the compliance program is effective and whether any changes are necessary.

Within the antitrust compliance program outlined, the entrepreneur will need to develop guidelines and standards regarding compliance with the specific provisions of the various laws. For example, the Robinson-Patman Act is concerned with price discrimination. Personnel conducting an audit of the firm's antitrust practices might be given guidelines such as the following:

To determine whether Robinson-Patman violation has occurs, auditors should ask if the company has made sales—

- at different prices;
- within a reasonable contemporary time period (this may vary depending upon the competitive market; 6 months is a good rule of thumb);
- in interstate commerce (however, price discrimination occurring totally intrastate may violate state laws);
- of products of like grade and quality (no significant difference from a commercial standpoint);
- to customers where injury to competition at the seller, buyer, or subbuyer level will probably result.

If any of these criteria are present, the price difference may nevertheless, be defended under the law if—

- the price was given to meet (not beat) competition,
- the prices charged may be justified on a cost basis, and/or
- the market or the marketability of goods has changed.

WHAT STEPS CAN BE TAKEN TO COMPLY WITH LAWS PROTECTING EMPLOYEES?

Many government regulations exist for the purpose of protecting employees. State and local governments have enacted their own laws, but the major employee protection laws have been passed by the federal government. This legislation provides safety, fair wages, and equality for all employees.

A major concern of government regulations is the health and safety of employees on the job. The **Occupations Safety and Health Act (OSHA)** is one of the most important pieces of legislation protecting employees. This act was written to make all employers responsible for providing a safe and healthful workplace. Most workers are covered by OSHA Acts. Many states have adapted the provisions of OSHA Acts and have even developed legislation of their own to protect employees.

OSHA Acts maintain the health and safety of the workplace by establishing standards and conducting inspections of business premises. It is the entrepreneur's responsibility to know the standards and to ensure that the facilities and employees comply with the standards. OSHA Acts standards can be obtained from the regional offices. The *Federal Register* publishes changes in standards and can be purchased from the U.S. Government Printing Office.

In order to avoid OSHA Acts violations, you must be sure that your employees are familiar with OSHA Acts and your safety regulations. If you have more then 10 employees, you must keep a record of work-related injuries and illnesses. You should also become acquainted with OSHA Acts standards and the procedures to be used in performing a workplace inspection.

A second major employee protection concern is the economic status of employees. The **Fair Labor Standards Act** is intended to protect workers by providing minimum wages, maximum hours, overtime pay, equal pay, record keeping, and child labor limitations. The Act requires equal pay for equal work for all employees covered by minimum wage laws. The law does not prohibit paying different wages if the difference is based on seniority, quantity of work, or quality of work. If the jobs require the same skills, effort, and responsibilities, then an employer cannot pay one employee different wages than another.

The above acts may cover your employees, depending on your situation. Specific information can be obtained from your nearest office of Wage and Hour and Public Contracts Division, U.S. Department of Labor.

The **Federal Social Security Act** covers many employees. The Act provides monthly benefits to injured persons and their dependents in the event of retirement, disability, or death. The funds for these benefits come from a tax on workers and their employers.

The **Federal Social Security Act** also encourages all states to enact economic security laws. Protection from income loss due to industrial accidents and occupational diseases is provided through *State Worker's Compensation* laws. Worker's Compensation provides benefits for injured workers or their dependents, regardless of who is at fault. If a worker is killed or injured on the job, the worker or dependents collect. Payment is made according to a schedule based on the severity of the injury.

The employer pays the total cost of Worker's Compensation coverage, which is available through state or private insurance companies. Requirements vary from state to state. Worker's Compensation plans are usually administered by a state department of labor or a special board or commission.

An additional law in this area of employee protection is the **Pension Reform Act**. This law is designed to protect employee investments in company pension and profit-sharing plans. You should check with your state labor office to be sure of the exact rules and

regulations that apply to your business in the area of economic security for employee.

Fair employment practices is another broad area of concern regarding the protection of employees. Fair employment practices are established by the Federal civil Rights Act and the Americans with Disabilities Act. These acts make it unlawful to discriminate on the basis of race, religion, age, disability, or sex as a condition of employment. Also, many states have enacted fair employment practice laws. In hiring employees, an entrepreneur will be concerned with maintaining the standards established by such laws. An employer can get into trouble by asking pre-employment interview questions about race, age, disabilities, and marital status.

Additional laws concerning fair employment practices include the **Equal Pay Act**, the **Age Discrimination in Employment Act**, and the **Equal Employment Opportunity Act**. Small business owners would be wise to familiarize themselves with these laws.

Of all the regulations designed to protect employees, those regulations concerned with fair employment practices create the most problems for small businesses. An affirmative action program developed early in the life of a business will eliminate many potential problems.

Basic steps that the owner of a small business can take to develop an affirmative action program are as follows:

- Develop a written equal employment policy and affirmative action commitment.
- Designate an individual to direct the affirmative action program.
- Publish your equal employment policy and affirmative action commitment and distribute it within your company and to potential sources of recruitment.
- Review your employment system to identify potential or actual unfair employment practices.
- Develop programs to enhance equal employment and affirmative action goals.

In addition to general program outlined, specific procedures for complying with the laws should be developed. Small businesses will have problems with governmental agencies if the businesses act in ways that indicate a discriminatory attitude toward job applicants. Specific company procedures should be developed to ensure that applicants are not asked discriminatory questions, such as these:

- Are you married?
- Where does your spouse work?
- Do you have a disability?
- Have you ever been arrested?

Human resource legislation varies from state to state. State employee relations or human resource departments are responsible for enforcing labor and industrial safety laws. These agencies are also responsible for enforcing state minimum wage requirements. Look in the local telephone directory to locate the state agency that can provide the services and information you need.

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HOW DOES THE LAW PROTECT CONSUMERS?

Federal laws that are aimed at protecting consumers include the following:

- The Pure Food and Drug Act
- The Federal Credit Opportunity Act
- The Fair Credit Billing Act
- The Consumer Credit Protection Act
- The Federal Food, Drug, and Cosmetic Act
- The Fair Packaging and Labeling Act
- The Textile Fiber Products Identification Act

A major consumer complaint has been the difficulty of understanding various terms surrounding the borrowing of money. Legislation has provided credit protection to consumers. The **Consumer Credit Protection Act** is commonly called the "Truth-in-Lending" Act. If you extend credit to your customers, you will be affected by this law. This law is intended to ensure a clear explanation of credit terms. It requires that lenders explain credit terms so that the consumer will know exactly what the credit will cost. This will help the consumer to compare various credit offers. The law also provides that lenders tell the truth when loaning money or extending credit. They must disclose their credit terms and interest costs in prescribed standard vocabulary.

A second law, the **Equal Credit Opportunity Act**, is designed to ensure that consumers are not denied credit for reasons of sex, marital status, age, race, religion, or national origin. Another law, the **Fair Credit Billing Act**, was passed to provide consumers with an opportunity to dispute errors in billing statements. It also requires creditors to make an effort to correct such errors.

The **Food and Drug Administration (FDA)** is a federal agency within the Department of Health and Human Services. The FDA protects consumers by enforcing laws and regulations to prevent distribution of adulterated or misbranded foods, drugs, medical devices, cosmetics, and veterinary products.

The **Pure Food and Drug Act** forbids "adulteration and misbranding" of foods and drugs sold in interstate commerce. The **Federal Food, Drug and Cosmetic Act** added cosmetic and therapeutic devices to the FDA's jurisdiction. The legislation also revised the definition of misbranded food. The definition of *improper labeling* was broadened to include any "false and misleading" label. To assist in this area, the Congress passed the **Fair Packaging and Labelization Act** to prevent unfair or deceptive packaging or labeling of certain consumer goods.

Another area of consumer concern deals with product warranties. The **Magnusen-Moss Warranty Act** set standards for businesses offering warranties. The basic provision of the Act requires that warranties be written in language that is understandable.

WHAT STEPS CAN BE TAKEN TO COMPLY WITH LAWS PROTECTING CONSUMERS?

Consumers have been given many rights through legislative actions. Consumer groups have publicized these rights. The owner of a small business is working with a public that is increasingly informed of an expecting their rights. The practices of your business should be evaluated in terms of consumer rights, and appropriate policies should be developed to ensure compliance with consumer protection legislation. Examples follow of policies in the consumer credit area and warranty requirements that should provide some insight into the types of policies to be developed:

- The business will prohibit discrimination in granting credit on the basis of race, color, religion, national origin, sex, marital status, age, or because all or part of the person's income comes form public assistance programs.

- The business will provide a statement of finance charges in a uniform matter to all customers.

- The business will notify all customers of the annual percentage rate.

- The business will comply with all legal methods for resolving disputed billings and correcting statements.

If you offer credit to your customers, you probably should request the pamphlet *What You Ought to Know about Truth-in-Lending.* This document is free from any Federal Reserve Bank or from the Board of *Governors of the Federal Reserve System* in Washington, D.C.

The **Magnusen-Moss Warranty Act** and the follow-up Federal Trade Commission (FTC) rules have had a great effect on both manufacturers and retailers. Business people who sell consumer products that are priced above $15.00 and who offer written warranties must conform to the provisions of the Act and of the FTC rules. The FTC rules regulating the Magnusen-Moss Warranty Act are outlined in *The New FTC Disclosure of Written Consumer Product Warranty Terms and Conditions*, available from the FTC. The basic provisions of warranties, as explained in these rules and in the Act, generally require the warrantor to disclose information "in simple and readily understandable language."

Company policies concerning written warranties should address the following:

- What the warranty covers (parts, labor, workmanship)

- What the warranty excludes (abuse, commercial use)

- What the warrantor will do if the product fails (repair, replace)

- Step-by-step instructions the purchaser must follow to get the warranty honored.

WHAT STEPS CAN BE TAKEN TO COMPLY WITH LAWS PROTECTING THE ENVIRONMENT?

In recent years, concern about protecting the environment has resulted in the passing of many antipollution laws. Industrial wastes pollute many of our lakes and streams. In response to these problems, much federal legislation has been passed including the following:

- The Clean Air Act
- The Solid Waste Disposal Act
- The Water Quality Act
- The Noise Control Act
- The Toxic Substances Control Act

These and other laws affect small business operations. The types and cost of facilities used and their locations are determined in part by environment regulations. Larger shares of a company's investments are tied up in costs of complying with these regulations.

The *Environmental Protection Agency (EPA)* is responsible for enforcing laws protecting the quality of our environment. State and local agencies also control similar statutes within their jurisdictions.

A first step to take is to contact the EPA or a local environmental agency concerning any responsibility—in general terms—that you may have concerning environmental controls. Retail establishments are not affected as much by laws in this area as are manufacturing concerns. Businesses such as foundries and copper smelting plants have a much greater responsibility for clean air than does a retail men's apparel shop.

If you have determined that environmental legislation has a significant effect on your business, then policies should be established for the following:

- What product lines should be developed?
- Under what conditions can the products be produced?
- Where can the business facilities be located?
- What will be the environmental impact?

WHAT LICENSES AND PERMITS ARE NEEDED?

Licensing usually means registering a business. Certain types of businesses are commonly licensed. Paying a fee to obtain the license is also common. Sometimes an inspection of the business is required.

Most enterprises must be licensed by a local or state agency before opening for business. State governments restrict entry into various professions and types of businesses by requiring licenses. Additional regulations might be required of the business, such as a yearly inspection of the business by a state

government agency or payment of an annual tax.

If you plan to hire employees, you must obtain an employer's Social Security Identification number through the *Internal Revenue Service (IRS)*. This is really a type of "license."

Many states, counties, and municipal governments issue licenses and permits to various types of business. These requirements vary from state to state and from one municipality to the next.

States that have sales taxes and "use" taxes usually require businesses to obtain a special permit or license. This license allows the business to give the permit number when purchasing goods for resale instead of paying sales tax. Since the sales tax is a consumer tax, the business is requires to collect the tax when selling merchandise to consumers. Business owners must periodically remit the taxes collected.

Every enterprise must also conform to local zoning laws, comply with building codes, and meet standards set by local health, fire, and police departments.

The following businesses are usually licensed:

- Restaurant and food-handling businesses
- Barber shops and beauty salons
- Cleaning and laundering establishments
- House-to-house peddlers and solicitors
- General stores
- Liquor stores
- Finance and lending institutions
- Dealers and local distributors
- Transportation businesses
- Businesses operating in a foreign state
- Hotel and motels
- Insurance companies

WHAT IS A CONTRACT?

A contract is a mutual agreement made between two or more persons that is valid and enforceable by law. It does not have to be written in order to be legal. In fact, oral contracts can be enforced providing their terms can be established in a court of law. Sometimes, however, oral contracts can present problems. With oral contracts, it may be difficult to establish what has been agreed upon. Each party may be relying on personal memory and bias.

When money is involved, it is typical to put contracts in writing. In addition, the following conditions call for a written contract:

- Any contract for the sale of land or an interest in land

- Any contract that will not be performed within one year
- A promise by one person to pay the debts of another
- Any contract that involves the purchase of real property valued at $500 or more

In examining when to use a written contract, it is safest to use a written contract in all but minor matters. This way, if there is a problem with the contract, the business person can spend time trying to get performance on an award for damages rather than arguing over the terms of the contract that were initially agreed upon.

As a small business owner, you need to know the major requirements of a contract. These requirements cause the contract to be legal and binding. Knowing these requirements will increase your awareness of some of the problems that are encountered in the enforcement of contractual agreements. The major requirements of a contract are often called the five essentials of a contract.

WHAT ARE THE MAJOR ELEMENTS OF A CONTRACT?

The five essentials of a contract are (1) *agreement*, (2) *consideration*, (3) *contractual capacity*, (4) *legality of purpose*, and (5) *reality of consent*. Contracts that are enforceable by law have these five items.

The first and most important element of the contract is agreement. For agreement to exist, there must be a reasonably definite understanding between the parties. Agreement occurs under certain conditions. Firstly, an offer is made. An *offer* is a proposal that expresses a desire to enter into a legally binding agreement. The offer is followed by *acceptance*. Acceptance occurs when the party to whom an offer has been made agrees to the proposal. The offer and acceptance create a reasonably definite understanding between the parties who are involved in the contract. Some of the most important ingredients for agreement are intent to contract, reasonable definiteness, and communication. Let's take a closer look at these items.

Sometimes people talk business in *exploratory terms*. There is no agreement and no contract. In order for a contract to exist, the parties involved must intend to contract. This means that all parties must desire to enter the contract and to meet the terms of the contract.

In order for an agreement to exist, the offer has to be reasonably definite. This means that the terms have to be specific enough so that it can be determined that the parties to the contract have lived up to their promises.

Another item that is necessary for agreement is *communication*. In order to have a contract, an offer has to be communicated to the offeree.

A second requirement for a legal contract is *consideration*. Consideration is something of value that is given to the offeror by the offeree. What constitutes consideration? One of the ways in which the courts have attempted to answer this question is with the detrimental test.

Will the person bringing the suit suffer a loss or damage if the contract is not carried out? Has the person already suffered a loss? If the answer is yes, the courts will hold that consideration existed.

Another requirement of a legal contract is that of *contractual capacity*. All parties to the contract must have the intellectual ability to make legally binding agreements. Individuals who have the capacity to contract are known as competent parties.

Those who do not have the capacity to contract are classified as incompetent. They include persons who are mentally ill or insane, intoxicated by drugs or liquor, or under legal age.

Still another requirement of a contract is legality of purpose. Contracts in violation of the law are not enforceable. A contract must be legal in its objective. It must not be contrary to the interests of society in it formation, purpose, or performance.

The final requirement for a contract is *reality of consent*. This is missing when he agreement contains fraud, innocent misrepresentation, or mistakes.

It takes agreement, consideration, contractual capacity, legality, and reality of consent to make a contract. When all five factors are present, we have a contract. Without them, we do not have a contract.

WHAT ARE THE MOST COMMON TYPES OF CONTRACTS?

The two most common types of contracts are *lease contracts* and *sales contracts*. At this point in time, you will have an opportunity to learn more about lease and sales contracts. As you start your business, you will probably lease a site for the business rather than buy it. For this reason, it is important for you to become acquainted with leases and their terms.

WHAT IS A LEASE?

A *lease* is a special contract that establishes a relationship between a property owner and a tenant. A tenant (lessee) has possession of the real property of the property owner (lessor). Rent is the payment given by the tenant to the property owner. Many states have laws or statutes regarding these leases. In some states, if the leasing period is longer than one year, the contract must be in writing to be enforceable.

There are various types of leases that a business can sign. Selecting the "right" lease depends on the circumstances, type of business, and common leasing practices within industry. There are four types of leases:

- **Tenancy for Years.** The site is leased for a definite period of time. The lease can last 6 months, 1 year, 5 years or 99 years.

- **Tenancy from month-to-month.** The site is leased month by month, and rent is paid by the month.

- **Periodic tenancy.** The site is leased for an indefinite period of time with rent due at specified intervals.

- **Tenancy at will.** The site is leased for an indefinite period of time. The lease can be continued indefinitely or can be terminated by either party.

Since a lease is a legal document, it is important that certain precautions be observed before the lease is signed. Examine the property thoroughly to make sure that it suits the purpose for which it is to be used. Make sure that the signatures are properly witnessed. Examine the lease thoroughly to make sure that it contains the following:

- A narrow restrictions on merchandise that may be sold or on services that may be prohibited

- Statements of the duration of the lease, the amount of rent, the date on which the rent is to be paid, and the penalty for late or nonpayment

- Arrangements for subleasing, subletting, and assignment to another merchant

- Provisions in case of fire or other hazards

- Mutual obligations concerning major and minor repairs

- Options and renewal arrangements

Often businesses lease more than the firm's premises. Even though leasing rates are usually higher than rates charged for purchasing the equipment on credit, many small firms lease equipment, including trucks. It is not uncommon to find service, wholesale, retail, and manufacturing firms leasing data processing equipment, photocopying equipment, and company cars.

Leasing has some very definite advantages because it—

- does not tie-up capital,

- eliminates the need for some types of insurance protection,

- saves taxes, because lease payments are tax-deductible,

- eliminates possession of outdated equipment and so forth (when new models become available most lease agreements allow the lessee to exchange the equipment for the new models), and

- saves on maintenance costs since those costs are usually included in the terms of the lease.

WHAT ARE SALES CONTRACTS?

A distinction must be made between a *sales contract* and a *contract to sell.* The **Uniform Commercial Code** (CC) states that

"*Contracts for sale* includes both a present sale of goods and a contract to sell goods at a future time." A sale consists in passing the title from the seller to the buyer for one price." A *contract to sell* means that the title of goods is to pass at a later time.

As a small business owner, you will deal with a variety of sales contracts. These contracts may involve sales to customers or items that you intend to purchase. You may even work with a sales contract in order to purchase your own small business.

If you decide to purchase an existing small business, you will need to develop a sales contract. You may want to have your lawyer draw up the agreement. This will help to ensure that it covers all essential points and that the agreement is understood by all parties.

If you purchase an existing business, you will want to have the following items covered in the agreement:

- A description of what is being sold
- The purchase price
- The method of payment
- A statement of how adjustments (such as inventory sold, rent, payroll, and insurance premiums) will be handled at the time of closing
- Buyer's assumption of contracts and liabilities
- Seller's warranties (such as warranty protection for the buyer against false statements of the seller, inaccurate financial data, or undisclosed liabilities)
- Seller's obligation and assumption of risk pending closing
- The covenant of the seller not to compete with the business
- The time, place, and procedures of closing

There are several things that you will want to remember if you are purchasing an existing small business. One of these is the fact that the seller and the buyer must comply with the bulk sales law of the state in which the transaction takes place. This law will help to protect the buyer of the business. It is designed to ensure that the seller does not sell out the business, pocket the money from the sale, and disappear leaving the creditors unpaid.

As a result of the bulk sales law, the seller will need to furnish a sworn list of creditors to the buyer. The buyer will give notice to the creditors of the pending sale. If that does not happen, the seller's creditors could possibly be able to claim the personal property that the buyer has purchased.

The buyer of the business will want to take possession of the business as soon as possible after signing the contract. This will keep the seller from depleting the inventory or from creating ill will for the buyer as the business is taken over.

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HOW CAN BUSINESS IDEAS BE PROTECTED?

In the process of doing business, small business owners many times have an opportunity to originate a new idea for a product or process. If so, they may wish to take steps to protect their idea through *patents*, *trademarks*, *service marks*, or *copyrights*. Let's take a closer look at these items and see how they can be used to protect business ideas.

If an item is invented in the process of operating a business, it may qualify for a *patent*. Patents may be obtained on new products, industrial or technical processes, machines, designs, or other items involved in the process of doing business. A patent provides the exclusive rights to the inventor to make, use, or sell the invention for a period of years. Patents on new devices are valid for a period of 17 years.

Patents are granted by the Patent and Trademark Office of the federal government. In order to obtain a patient an inventor must go through the patient application process. The process of getting a patent is very detailed and time consuming. Most inventors find it necessary to hire a patent attorney or registered patent agent to help them through the process.

An invention must be *new* and *unique* in order to qualify for a patent. It cannot simply be a reworked version of an existing idea. A patent search is conducted to determine whether something is new and unique. The search process involves checking millions of patients on record with the Patient and Trademark Office to determine if anyone has ever obtained a patient on a similar invention. Patent search specialist are usually hired to perform the search.

If the search shows that the invention is new and unique, a patent application is submitted. The application includes a description of the invention and its patentable new features. It is filed with the Commissioner of Patients and Trademarks along with a filing fee.

The patent application must be filed within 1 year from the time the invention is offered for sale, used in public, or described in print. An invention should be marked "Patent Pending" if it is made public after a patent application is filed. This lets others know that the invention is being patented.

The Patent Office reviews the application to determine if has been done correctly. If it meets the requirements, the application is accepted and the invention reviewed to see if it is in fact new and unique. If it is, a patent is issued; if not, the application is rejected. The inventor can appeal a rejection.

A *trademark* is a word, name, symbol, device (design), or a combination of these items that is used to identify a product. When a trademark is registered, that trademark is protected against use by others for a period of 20 years. The symbol ® denotes a registered trademark.

The trademark is a device pointing directly to the origin or ownership of merchandise to which it is applied. The trademark is legally reserved to the exclusive use of the owner as maker or seller of the product. The "Golden Arches" symbol used by McDonald's restaurants is a good example of a trademark. No one else is allowed to use the "Golden

Arches" because it is a registered trademark of McDonald's.

Like a trademark, a *service mark* is a word (or words), design (or designs), or combinations of word(s) and design(s) used to advertise services. A service mark helps customers to distinguish the services of one firm from those of another. These marks are used to advertise banking, real estate, motel, and other services. Through such advertising, prospective customers become aware of a firm's services. When they see the service mark, they associate it with a particular level of quality.

Trademarks and service marks are registered with the Patents and Trademarks Office. The product must actually be used before it can be registered. A company can not reserve a trademark or a service mark.

Printed material such as literary and artistic work is protected through *copyrights*. Copyrights are effective for the life of the author plus an additional 50 years. Small business owners may desire to copyright material used in advertising. For example, catalogs, brochures, or instruction sheets regarding products and services can be copyrighted.

A work is copyrighted by marking it with the © symbol. Copyrights do not have to be registered. However, a copyright must be registered in order to bring an infringement lawsuit. Copyrights can be registered by filing a form with the Copyright Office and paying a small fee in the Library of Congress.

HOW CAN THE SMALL BUSINESS OWNER REDUCE LEGAL PROBLEMS?

Systems and procedures can help reduce legal problems involving customers, suppliers, employees, and others. For example, to have proof of delivery, the retailer should insist on a signature for goods. Then, the business will be protected should any problems develop.

An entrepreneur must recognize the advantage of avoiding litigation whenever possible. This will not only save time, but will also avoid jeopardizing the firm's relationship with the many people with whom it does business.

A properly drawn agreement or contract can help avert litigation. If a matter is too small for a formal agreement, an exchange of letter may be useful. It is impractical to legalize every business transaction, but it is vital for you to put important agreements in writing.

In addition, you will need to manage the firm with discipline. You will also need to make careful decisions when facing a major legal risk. Careful decision making is also in order when contracts are signed or other written commitments are made.

As a small business owner, you should gain a basic understanding of statutes and regulations that affect your firm. This will enable you to deal with minor legal problems and to recognize when it is necessary to get legal counsel or appropriate nonlegal advisors to help with complex problems.

ACTIVITIES

The following activities are designed to help you apply what you have learned in this unit.

INDIVIDUAL ACTIVITIES

A.

To test your understanding of the legislation presented in this unit, write a two or three-sentence summary of the issued covered by each of the following acts:

- The Sherman Act
- The Clayton Act
- The Federal Trade Commission Act
- The Occupational Safety and Health Act
- The Federal Social Security Act
- The Pension Reform Act
- The Pure Food and Drug Act

B.

Go to your local library and consult newspapers and magazines, such as *Business Week*, *Fortune*, *Wall Street Journal*, *New York Times*, *Forbes*, *Inc. Magazine*, and *The Entrepreneur*. Identify articles that discuss business activities related to the legal issues presented in this unit (e.g., pollution, anti-trust, employment discrimination, interstate commerce, etc.). Develop a table to present the article and the publication where you located that article, the legal issue presented in the article, and possible regulations and laws pertaining to that particular legal issue, and the company involved.

GROUP ACTIVITIES

A.

Work in teams of four to six. Lead a discussion on how the government's ever-increasing environmental legislation together with the increasing public awareness of environmental concerns have an impact of the future business operations. Consider the Clean Air Act, Solid Waste Disposal Act, Water Control Act, Noise Control Act, and Toxic Substance Control Act in your discussion. Organize a field trip to your local library to gather more details about these regulations in order to support your discussion.

B.

Continue working in teams. Use your local library as a source to learn more about the following regulations related to employment practices:

- The Equal Pay Act

- The Age Discrimination in Employment Act
- The Equal Employment Opportunity Act
- The Federal Civil Rights Act
- The Americans with Disabilities Act
- Fair Labor Standards Act
- The Occupational Safety and Health Act

Each team should choose one of the above-mentioned legislations and develop a one-page summary based on the library research findings. The teams will convene and share their findings in a class discussion. Team members should also prepare a brief imaginary case to support and exemplify the researched regulation.

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CASE STUDY

Paula French has a successful computer repair shop. She is renting space in a small shopping center located next to a large university. She has used the highly visible location to help her become established in the university area.

Paula is in the process of renewing her lease. Her current lease was a month to month lease that was never put into witting. Recently a large corporation purchased the building from her landlord. The new owner is requiring a written lease for each tenant.

The lessor has offered several options for the type of lease. It can be a tenancy for years, tenancy from month to month, periodic tenancy, or tenancy at will. The lessor has indicated that the longer the lease lasts, the lower the monthly rent payments will be. The lessor has agreed to pay up to $2,000 for a new sign Paula if she signs a lease with a term of at least five years. The form lease that the lessor has shown Paula indicates that she would be responsible to make repairs on her space. In addition, any major alterations to the property must be approved by the lessor in witting.

The lease has several other provisions that trouble Paula. She would also be responsible for any injuries or damages suffered by a third party on her portion of the property. She can not sublet the property. If the property is damaged by fire, the lessor would have six months to repair the property. After six months Paula could terminate the lease if the property was not fixed. She would have to get the lessors permission to install new fixtures and any fixtures would be the property of the lessor when the lease ended.

DISCUSSION QUESTIONS

1. If you were faced with this situation would you negotiate the lease yourself. Would you seek the advice of an attorney. Why or why not?

2. What type of lease would be best for Paula? What factors support your choices?

3. What other provisions should Paula get written into the lease?

ASSESSMENT

Read the following questions to check your knowledge of the topics presented in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. Explain the sources and purpose of regulations in the United States.
2. What do the Clayton Act, The Robinson-Patman Act, and the Sherman Act have in common.
3. Identify OSHA and its purpose.
4. What is meant by the term contractual capacity?
5. What is the first step that a business needs to take to comply with laws protecting the environment?

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PACE

Unit 1. Your Potential as An Entrepreneur
Unit 2. The Nature of the Small Business
Unit 3. Business Opportunities
Unit 4. Global Markets
Unit 5. The Business Plan
Unit 6. Help for the Entrepreneur
Unit 7. Types of Ownership
Unit 8. Marketing Analysis
Unit 9. Location
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Unit 11. Financing the Business
⇨ Unit 12. Legal Issues
Unit 13. Business Management
Unit 14. Human Resources
Unit 15. Promotion
Unit 16. Selling
Unit 17. Record Keeping
Unit 18. Financial Analysis
Unit 19. Customer Credit
Unit 20. Risk Management
Unit 21. Operations
Resource Guide
Instructor's Guide

Units on the above entrepreneurship topics are available at the following levels:

* Level 1 helps you understand the creation and operation of a business
* Level 2 prepares you to plan for a business in your future
* Level 3 guides you in starting and managing your own business